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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1966

No. 478

E. TAYLOR CHEWNING AND CAROLINE M. CHEWNING, Husband and Wife, *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT.

The petitioners, E. Taylor Chewning and Caroline M. Chewning, husband and wife, by their attorney pray that Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above styled case on June 22, 1966.

Opinions Below

The Tax Court of the United States filed its findings of fact and opinion on July 30, 1965. It is reported as 44 T.C. 678 and is printed as Appendix B, *infra,* pages 11-23. The opinion of the United States Court of Appeals for the Fourth Circuit was filed on June 22, 1966. It is not yet printed in the official reports, but is printed here as Appendix C, *infra,* pages 24-25.

Jurisdiction

The opinion and judgment of the United States Court of Appeals for the Fourth Circuit were both filed on June 22, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Question Presented

Whether an otherwise qualifying casualty loss from damage to property held for personal purposes is subject to the provisions of Section 1231 of the Internal Revenue Code of 1954, even though the loss was wholly uncompensated for by insurance or otherwise and admittedly deductible in full as an ordinary loss under Section 165 (c) (3) if not covered by Section 1231 of said Code.

Statutes Involved

The applicable portions of the pertinent statutes are set forth in Appendix A, *infra*, pages 9-10.

Statement [1]

The petitioners, E. Taylor and Caroline M. Chewning, are husband and wife who resided at Tacara Farm, Tracy's Landing, Maryland, during the taxable year here involved. They filed a joint Federal income tax return for the year 1960 with the District Director of Internal Revenue at Baltimore, Maryland.

During the month of December, 1960, approximately 172 English boxwood bushes located on the taxpayers' residence at Tacara Farm were destroyed by a severe snow storm. The taxpayers suffered a loss in the stipulated amount of $8,500 as a result thereof, which loss was not compensated for by insurance or otherwise. The taxpayers' residence

[1] In the Tax Court all the facts were stipulated and there was no testimony.

and the English boxwood bushes had been held by the taxpayers for more than six months prior to December, 1960.

In their joint income tax return for the taxable year 1960 the taxpayers reported as long-term capital gains, the amount of $13,710 resulting from the sale of breeding cattle. The taxpayers deducted, in such return, the amount of $9,100 as a casualty loss resulting from the destruction of the boxwood bushes. As stated above, this amount has been reduced to $8,500 by stipulation.

In the statutory notice of deficiency the respondent determined that the loss sustained was not deductible as an ordinary loss under Section 165, but constituted a loss subject to treatment under Section 1231, and was to reduce the gain reported from the sale of the breeding cattle. The Tax Court sustained the Commissioner's determination. On appeal, the Fourth Circuit affirmed the Tax Court.

Reasons for Granting the Writ

The decision below should be reviewed because it is in direct conflict with the decision of the Court of Appeals for the Tenth Circuit in the case of *Maurer* v. *United States*, 284 F. 2d, 122 (C.A. 10, 1960). Review is also appropriate because of the effect this decision has on large numbers of taxpayers. The particular type of loss here involved is not unusual and is sustained by taxpayers constantly. Due to the conflict in Circuits, taxpayers are now faced with the problem of whether to deduct the loss as an ordinary loss and be confronted with possible litigation or not the loss against Section 1231 gains.

The Commissioner may contend that there is no conflict because the taxable year involved in the *Maurer* case, *supra*, was prior to the passage of the Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1601, Section 49(a). Such an argument is without merit since the act in question did not

change the substantive meaning of Section 1231(a) but simply excluded from its coverage uninsured losses arising from the destruction, etc., of (1) property used in a trade or business, and (2) capital assets held for more than six months and held for the production of income.

Thus, no change was made to the applicability of Section 1231(a) to the type of loss involved in the instant case.

The court should examine the law as originally written in order to decide the question at hand. The original statute was included in the Revenue Act of 1942 (c. 619, 56 Stat. 798, Section 151 (b)) which added subsection (j) to Section 117 of the 1939 Code. Subsection (j) is the predecessor to Section 1231(a) of the 1954 Code, before the 1958 amendment.

The Commissioner has argued that a great deal of weight should be placed upon the Congressional Committee Reports explaining the 1958 amendment. Since the 1958 amendment is not the controlling statute, it is more beneficial if one examines the Committee Reports of the Congress which passed the original statute. The Committee Reports of the 77th Congress, the Congress that enacted Section 117(j) of the 1939 Code, point out that the intention of that Congress was not to classify uncompensated for losses as an involuntary conversion, but to classify what would otherwise be ordinary gains as capital gains. The portion of the House Report which relates to the enactment of Section 117(j) of the 1939 Code (H.R. Rep. No. 2333, 77th Cong., 2d Sess. pp. 53, 54) states the following:

> 25. GAINS AND LOSSES FROM INVOLUNTARY CONVERSIONS FROM THE SALE OR EXCHANGE OF CERTAIN DEPRECIABLE PROPERTY.
>
> Under existing law, the gain or loss from the sale or exchange of depreciable property is not treated as a capital gain or capital loss, but as an ordinary gain or

an ordinary loss. This rule was originally inserted as a relief provision to enable corporations to have the full benefit of a loss from the sale of machinery, instead of being limited by the capital loss provisions, which would permit it only a certain percentage of the loss. It was felt at that time that the taxpayer should not be denied the full loss because it sold the property at a loss instead of abandoning the property. While this rule provided relief in case a loss was realized, it appears that many taxpayers are able to dispose of their depreciable property at a gain over its depreciated cost. To treat such a gain as an ordinary gain will result in an undue hardship to the taxpayer. For example, a taxpayer sells certain trawlers used in his business to the Government. If the gain from the sale is regarded as an ordinary gain, it may result in the taxpayer receiving practically nothing for his property. *Another example is where the proceeds of insurance on destroyed property exceed the cost of the property. The existing law treats such gain as an ordinary income. The gain or loss resulting from the involuntary conversion of property into other property or money is also treated as an ordinary gain or loss. The theft of an article which is insured, is an example in point.* Your Committee has provided the following solution for this problem:

(a) If the total gain in such cases exceed the losses, such gains shall be considered as gains from the sale or exchange of capital assets held for more than 15 months. Buildings and similar real property improvements are not included in this provision, unless gains or losses therefrom result from an involuntary conversion. This is because buildings and similar real property are treated under a different provision of the bill. In deter-

mining whether the gains exceed the losses, 100 percent of such gains or losses are taken into account. In the case of involuntary conversions, the existing law is amended to provide that the loss shall be recognized upon the conversion.

(b) If the gains do not exceed the losses in such cases, such gains and losses will be treated as ordinary gains and ordinary losses instead of capital gains and capital losses. Where the losses exceed the gains, the excess loss will be deductible from income as an ordinary loss. (Emphasis supplied.)

It is clear from the language of this Committee Report that the intention of Congress was to grant relief to individuals who were able to sell or exchange a depreciable asset at a gain. Under the law at the time of the enactment of subsection (j) of Section 117 of the 1939 Code, the gain or loss from the sale or exchange of depreciable property was treated as an ordinary gain or an ordinary loss.

"It was felt at that time that the taxpayer should not be denied the full loss because it sold the property at a loss instead of abandoning the property." This sentence, found on page 54 of the House Report referred to above, states what the original intention of Congress was when it granted taxpayer the privilege of having the losses from the sale of depreciable assets treated as an ordinary loss. It was felt that the taxpayers should not be penalized because the asset was sold or exchanged rather than abandoned. The passage of what is presently Section 1231(a) was to grant further relief to those taxpayers who were fortunate enough to sell or exchange their depreciable property and realize a gain. Thus, the addition of 1231(a) was not to grant relief to taxpayers in the form of permitting them to have ordinary losses on the conversions of depreciable property into other assets but rather to allow them to tax any net gains on the conversions of these assets as capital gains.

It was, originally, the intention of Congress that "the taxpayer should not be denied the full loss because it sold the property at a loss instead of abandoning the property." Congress did not want to penalize the taxpayers for not "abandoning" the property. An uninsured casualty loss is as close to an abandonment as one can have. The above-mentioned Committee Report and especially the italicized portion thereof, demonstrates that the enacting Congress did not intend to have an uninsured casualty loss or abandonment loss included in the formula of 1231(a). These losses have always been governed by the provisions of Section 165.

The precise question before the Circuit Court below has never been ruled upon by this Court. In this sense, the present case is one of first impression. The petitioners contend that the decision below is erroneous because Section 1231(a) is clearly aimed at involuntary conversions of capital assets held for more than six months *where other property or money is received in return.*

Conclusion

For the reasons set forth above, it is respectfully submitted that this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A

INTERNAL REVENUE CODE OF 1954

SEC. 165. LOSSES

(a) General rule. There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * * * * *

(c) Limitation on losses of individuals.—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) Losses incurred in a trade or business;

(2) Losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

(3) Losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. * * *

SEC. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS

(a) General Rule. If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from

sales or exchanges of capital assets. For purposes of this subsection—

. . . . . .

(2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

In the case of any property used in the trade or business and of any capital asset held for more than 6 months and held for the production of income, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft.

. . . . . .

APPENDIX B

OPINION

Filed July 30, 1965

44 T. C. No. 63

TAX COURT OF THE UNITED STATES

Docket No. 3991-63

E. TAYLOR CHEWNING, CAROLINE M. CHEWNING, *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

The petitioners in 1960 suffered a loss, not compensated for to any extent by insurance or otherwise, from the destruction by storm of boxwood bushes located at their personal residence. *Held*, that such loss is not deductible as an ordinary loss under section 165(c) (3) of the Internal Revenue Code of 1954, but must be applied, pursuant to the provisions of section 1231 of the Code, in reduction of the petitioners' gains from sales of property used in the petitioners' trade or business.

WAYNE KENDRICK, for the petitioners.

STUART E. SEIGEL, for the respondent

OPINION

ATKINS, *Judge:* The respondent determined a deficiency in income tax for the taxable year 1960 in the amount of $3,703. The petitioners having conceded one issue, the only remaining issue is whether a loss sustained as a result of the destruction, by a severe snow storm, of boxweed bushes located on petitioners' residential property, is deductible under section 165(c) (3) of the Internal Revenue Code of 1954 as an ordinary loss, as claimed by the peti-

tioners, or must be applied, pursuant to section 1231(a) of the Code, in reduction of the gains from sales of property used in the petitioners' trade or business, as determined by the respondent.

The facts are stipulated and the stipulations are incorporated herein by this reference.

The petitioners are husband and wife residing at Tacara Farm, Tracy's Landing, Maryland. They filed a joint Federal income tax return for the taxable year 1960 with the district director of internal revenue at Baltimore, Maryland.

During the month of December, 1960, approximately 172 English boxwood bushes located on the petitioners' residential property at Tacara Farm were destroyed by a severe snow storm. The petitioners suffered a loss in the amount of $8,500 as a result thereof, which loss was not compensated for by insurance or otherwise. The petitioners' residence and the English boxwood bushes had been held by them for more than six months prior to December, 1960.

In their joint income tax return for the taxable year 1960 the petitioners reported, as long-term capital gain, the amount of $13,710 received from the sale of breeding cattle. In such return the petitioners deducted the amount of $9,100 as a casualty loss resulting from the destruction of the boxwood bushes. In the notice of deficiency the respondent determined that the loss sustained with respect to the boxwood bushes was $8,500. He determined that such loss was not deductible as an ordinary loss under section 165 of the Internal Revenue Code of 1954,[1] but constituted a loss sub-

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[1] Section 165 of the Code provides in part as follows:

(a) General Rule.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * * * *

(c) Limitation on Losses of Individuals.—In the case of an individual, the deduction under subsection (a) shall be limited to—

* * * * * * *

(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. ***.

ject to treatment under section 1231 of such Code,[2] and thus operated to reduce the gain reported from this sale of breeding cattle.

The parties are apparently in agreement that the capital gain of $13,710 reported from the sale of breeding cattle constituted gain from the sale of property used in the petitioners' trade or business, within the meaning of section 1231, and that the boxwood bushes were capital assets held for more than six months. In any event, neither party raises any question in these respects.

The petitioners do not contend that casualty losses with respect to capital assets not used in a trade or business and not held for the production of income are excluded from losses from involuntary conversions referred to in

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[2] Section 1231 of the Code, as it existed during the year in question, provided in part as follows:

> (a) General Rule.—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat of imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—
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> • • • • • • •
>
> (2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.
>
> In the case of any property used in the trade or business and of any capital asset held for more than 6 months and held for the production of income, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft.

section 1231.[3] They do contend, however, that since the loss on the boxwood bushes was not compensated for by insurance in any amount, there was no conversion thereof into money or other property, that therefore the loss sustained is not required by section 1231 to be applied against the gains referred to therein, and that hence such loss is deductible in full as an ordinary loss under section 165 (c)(3) of the Code.

Section 1231 of the 1954 Code is the successor to section 117(j) of the 1939 Code, which was enacted by section 151(b) of the Revenue Act of 1942. Sections 117(j) and 1231 in effect provide for the netting of gains and losses, recognized by other sections of the statute, from the sale or exchange of property used in the trade or business and from the compulsory or involuntary conversion of property used in the trade or business and capital assets held for more than six months, and provide that if the gains exceed the losses, the gains and losses shall be considered as being from sales or exchanges of capital assets held for more than six months, but that if the gains do not exceed the losses, the gains and losses shall not be considered as being from sales or exchanges of capital assets. And it is to be noted that, but for these provisions, gain on involuntary

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[3] In this connection it is to be noted that both section 1231 and its predecessor, section 117(j) of the Internal Revenue Code of 1939, refer to losses from the involuntary conversion of "capital assets held for more than 6 months," without reference to the purpose for which such assets are held. All regulations promulgated by the respondent since the enactment, by the Revenue Act of 1942, of section 117(j) of the 1939 Code, have treated casualty losses with respect to capital assets not held for the production of income as losses from compulsory or involuntary conversion within the meaning of section 117(j) and section 1231. The regulations have continuously set forth as one type of loss which must be included in the computation under section 117(j) and section 1231 the uncompensated loss sustained upon a pleasure yacht destroyed in a storm. Section 19.117-7 of Regulations 103, as amended by T.D. 5217, 1943 C.B. 314; section 29.117-7 of Regulations 111; section 39.117(j)-1(e) of Regulations 118; and section 1.1231-1(g) of the Income Tax Regulations under the 1954 Code. See also *J. H. Anderson*, 7 TCM 811, in which we stated that under section 117(j)(2)(B) of the 1939 Code a loss upon the destruction of a capital asset, such as a residence, held for more than six months is considered a loss from an involuntary conversion.

conversions of property as a result of casualty would be taxable as ordinary income, there being no sale or exchange. *Helvering* v. *Flaccus Oak Leather Co.*, 313 U.S. 247.

The provision in section 1231 of the 1954 Code that "losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion" is a re-enactment of the identical provision which appeared in section 117(j) of the 1939 Code.

Following the enactment of section 117(j) by the Revenue Act of 1942 the respondent, by T.D. 5217, 1943 C.B. 314, promulgated section 19.117-7 of Regulations 103, construing the above statutory provision as follows:

> In determining whether such gains exceed such losses for the purposes of section 117(j), losses upon the destruction in whole or in part, theft or seizure, requisition or condemnation of the property described in section 117(j) are included whether or not there was a conversion of such property into money or other property.

Substantially the same provision is contained in all subsequent regulations. Section 29.117-7 of Regulations 111; section 39.117(j)-1(a)(2) of Regulations 118; and section 1.1231-1(e) of the Income Tax Regulations under the 1954 Code.

The last sentence of section 1231(a) quoted in footnote 2 above, reading

> In the case of any property used in the trade or business and of *any capital asset* held for more than 6 months and *held for the production of income*, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft [emphasis supplied],

was enacted by section 49 of the Technical Amendments Act of 1958, and was made applicable to taxable years beginning after December 31, 1957.

We think that the fact that Congress excluded from the operation of section 1231 uncompensated casualty and theft losses sustained with respect to only property used in the trade or business or capital assets held for the production of income indicates the intent of Congress to include within the operation of that section casualty and theft losses with respect to capital assets *not* held for the production of income, irrespective of whether they are compensated for. That such was the intention of Congress is clearly shown, we think, by the Finance Committee Report with respect to the Technical Amendments Act of 1958 (S. Rept. No. 1983, 85th Cong., 2d. Sess.[4] In such report it is stated that

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[4] Such committee report states at page 74:

Under present law where there are uninsured losses on property as a result of its destruction, theft, seizure, requisition, or condemnation *such losses, in the case of* property used in the trade or business or *capital assets held for more than 6 months, are treated as section 1231 losses. These casualty losses* coming under section 1231 of the code *must be added together with* other gains and losses from sales or exchanges of property used in a trade or business and with *other gains or losses from involuntary conversions.* If the resulting net amount is a gain, under section 1231 it is treated as a long-term capital gain and in effect taxed at a rate no higher than 25 percent. If, on the other hand the net amount is a loss, under section 1231 it is treated as an ordinary loss which can be offset against income taxed at the regular tax rates.

Where a taxpayer elects to be a self-insurer against casualty losses, there seldom is a conversion into money or other property, as there would be if the destroyed property were insured. If this casualty loss were the only loss incurred during the taxable year by the self-insured person, he would be entitled to the full benefit of an ordinary loss deduction under section 1231, but where there are also 1231 gains, the casualty loss is partially or wholly offset against these gains which would otherwise be taxed as capital gains. As a result, the benefit of having casualty losses treated as ordinary, rather than capital, losses may be reduced or eliminated in the case of self-insurers, depending on the fortuitous circumstance as to what gains the taxpayer may have from trade or business assets or involuntary conversions. This is not a problem for those who are fully insured by others because they receive insurance payments in the case of destroyed property which offset the casualty losses which would other-

the general rule is that uninsured casualty losses with respect to capital assets held for more than six months are treated as section 1231 losses; that the amendment was intended to benefit business taxpayers who carry their own insurance; that the treatment provided therein (that is, the exclusion from the operation of section 1231 of casualty or theft losses not compensated for by insurance in any amount) applies *only* in the case of property used in the trade or business and in the case of capital assets *held for the production of income;* and that the new provision does not apply to loss arising from the destruction or theft of the taxpayer's uninsured personal automobile.

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wise be realized. Moreover, such persons may deduct currently the cost of their insurance for property used in a trade or business. Thus, in their case they obtain a deduction against ordinary income for any premiums paid and any gains from trade or business assets (or involuntary conversions) are taxed as capital gains and are not offset against losses (since these are covered by insurance) which would otherwise be treated as ordinary losses.

Your committee believes that this constitutes an unintended hardship and for that reason it has added a provision to the House bill amending section 1231(a) of the code. The provision added makes section 1231 inapplicable in the case of losses where the taxpayer is not compensated for the loss by insurance, if the loss arises from fire, storm, shipwreck, or other casualty or from theft. *This treatment is to apply, however, only in the case of property used in the trade or business and in the case of capital assets held for more than 6 months and held for the production of income.* The effect of this provision will be to treat such losses always as ordinary losses and never to offset them against gains which might otherwise be treated as capital gains. (Emphasis supplied.)

Such committee report also states as follows at page 203.

This is a new section for which there was no corresponding section in the House bill.

This section amends section 1231(a) of the 1954 Code by making it inapplicable to any loss in respect of which the taxpayer is not compensated by insurance in any amount if the loss arose from fire, storm, shipwreck, or other casualty, or from theft, and the loss occurred with respect to property used in the trade or business or a capital asset held for more than 6 months *and held for the production of income.*

Under section 1231, *uninsured casualty losses* on depreciable property or real estate used in the trade or business or *on capital assets must be aggregated with various other types of section 1231 gains*

Following the passage of the Technical Amendments Act of 1958, section 1.1231-1(e) of the Income Tax Regulations under the 1954 Code was amended by T.D. 6394, 1959-2 C.B. 186, to read as follows:

> (e) **Involuntary conversion.**—(1) General rule. For purposes of section 1231, the terms "compulsory or involuntary conversion" and "involuntary conversion" of property mean the conversion of property into money or other property as a result of complete or partial destruction, theft or seizure, or an exercise of the power of requisition or condemnation, or threat or imminence thereof. Losses upon the complete or partial destruction, theft, seizure, requisition or condemnation of property are treated as losses upon an involuntary conversion *whether or not there is a conversion of the property into other property or money unless subparagraph (2) of this paragraph applies. For example, if a capital asset held for more than 6 months, with an adjusted basis of $400, but not held for the production of income, is stolen, and the loss is not compensated for by insurance or otherwise, section 1231 applies to the $400 loss.* (Emphasis supplied.)
>
> (2) Certain uninsured losses. Notwithstanding the provisions of subparagraph (1) of this paragraph,

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and losses. If, in a particular taxable year, the recognized gains on sales or exchanges of section 1231 property plus the recognized gains from involuntary conversions of such property and capital assets held for more than 6 months exceed the recognized losses from such sales, exchanges, and conversions, the net gain is in effect treated as a longterm capital gain subject to reduced rates of taxation. If the losses exceed the gains, the net loss is in effect treated as an ordinary loss deductible from income from other sources. Consequently, whether an uninsured casualty loss will be deducted in whole or *in part against ordinary income or against gains subject to capital gain rates will depend on the overall gain or loss position of the taxpayer under section 1231 for the taxable year.*

Your committee has provided this section to separate certain uninsured casualty losses from the computation of section 1231 gain or loss, but only with respect to property used in the trade or business and *capital assets held for the production of income* which have been held more than 6 months. The amendment applies with respect to, for example, loss incurred as the result of the destruction of a tax-

losses sustained during a taxable year beginning after December 31, 1957, with respect to both property used in the trade or business and any capital asset held for more than 6 months *and held for the production of income,* which losses arise from fire, storm, shipwreck, or other casualty, or from theft, and which are not compensated for by insurance in any amount, are not losses to which section 1231(a) applies. Such losses shall not be taken into account in applying the provisions of this section. (Emphasis supplied.)

Section 1.1231-1(g) of the Income Tax Regulations sets forth an example in which a loss, not compensated for in any amount, sustained upon a pleasure yacht destroyed in a storm is treated as a loss subject to section 1231.

The Supreme Court has many times held that regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes, and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons. *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496. We think, particularly in view of the expression of Congressional intent contained in the committee report, that section 1.1231-1(e) of the

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payer's oil tanks which he used for oil storage in his trade or business, but on which he was unable to obtain insurance. *On the other hand, the amendment does not apply to loss arising from the destruction or theft of the taxpayer's uninsured personal automobile. The amendment is intended to benefit business taxpayers who,* because of the special hazards of their business or for other reasons, *carry their own insurance.* As compared with business taxpayers who carry insurance with outside insurance companies and can deduct the net premium cost of such insurance as ordinary business expense, the self-insured taxpayer cannot deduct amounts set aside in reserves to cover the contingency of a casualty loss. In the eventuality of such loss, it may be recognized as a capital rather than an ordinary loss deduction, depending on the overall gain or loss position of the taxpayer in the particular taxable year. Under this amendment, net gains with respect to section 1231 property continue to be treated as capital gains, but the casualty losses to which the amendment applies are fully deductible against ordinary income under section 165 of the 1954 Code. (Emphasis supplied.)

Income Tax Regulations is a reasonable interpretation of section 1231 of the Code, as amended by the Technical Amendments Act of 1958.

It is our conclusion that, except in the case of property used in the trade or business or capital assets held for the production of income, casualty losses are subject to the provisions of section 1231, as amended, whether or not compensated for by insurance in any amount.

We hold, therefore, that the respondent properly determined that the loss sustained by the petitioners with respect to the boxwood bushes is not deductible as an ordinary loss under section 165(c)(3), but must be applied against the petitioners' gain from sale of breeding cattle, pursuant to the provisions of section 1231.

The petitioners rely principally upon *Maurer* v. *United States,* (C.A. 10) 284 F. 2d 122, which they state decided the exact question here presented in favor of the taxpayer. In that case the court held that losses suffered in the taxable year 1954 as a result of destruction, by severe drought and abnormal weather conditions, of trees and valuable plantings on residential property, which were not compensated for to any extent by insurance or otherwise, were deductible as ordinary losses under section 165 of the Internal Revenue Code of 1954, and that section 1231 of the Code had no application. It took the view that section 1231 was applicable only to losses where there was a conversion into "other property or money," leaving section 165 applicable to uncompensated losses. The court stated in part:

> Section 165, and its predecessor 23(e), have traditionally been the means for deducting uncompensated casualty losses from income where, as here, the property is non-income producing. The casualty loss having been established by the special verdict of the jury in our case, it is deductible under Section 165 unless preempted by Section 1231. In other words, the two statutes are mutually exclusive and our problem is to put each into its proper frame of reference.
>
> The avowed purpose [of section 117(j) of the 1939 Code, predecessor of section 1231 of the 1954 Code] was to allow taxpayers, whose property had been seized

in furtherance of the war effort a capital gain rather than an increase in ordinary income. This is so because not infrequently the taxpayer received much more for his seized property than his depreciated cost, and it seemed unjust to tax him at wartime's exceptionally high income tax rates. Conversely, the legislation provided in the event a net loss was sustained, the taxpayer should be entitled to an ordinary deduction. * * *. Viewed in this light, it seems clear that Section 1231 is aimed at involuntary conversions where "other property or money" is received in return, i.e., compensated losses, leaving Section 165 applicable to uncompensated losses.

If a taxpayer has seen fit to insure his property, he is, in due course, compensated by his insurer and the loss reduced proportionately. If, however, the casualty is uncompensated, it seems to follow that he should be allowed an ordinary deduction. This is made clear when it is seen that Section 1231 is contextually similar to the sections dealing with capital gains and losses. Thus, a compensated loss is a taxable event closely akin to a "sale or exchange" albeit an involuntary one. Where, however, the taxpayer receives nothing in return, the factual situation is entirely different and there is no rational basis for capital loss treatment. If he can prove that the loss qualifies as a "casualty," it is only logical to conclude that Congress intended that there be an ordinary deduction under Section 165.

The respondent contends that the *Maurer* case [5] reaches an erroneous conclusion and urges that it not be followed. He points out that his regulations since the enactment of the Revenue Act of 1942 have continuously provided that losses from the destruction of property are to be considered

[5] In Rev. Rul. 61-54, 1961-1 C.B. 398, the Internal Revenue Service announced that it would not follow as a precedent the decision in the *Maurer* case and it would continue to adhere to the position that uncompensated casualty losses with respect to property not held for the production of income are within the purview of section 1231 of the Code.

as losses from involuntary conversions, whether or not converted into other property or money; that Congress, in the face thereof, reenacted in section 1231 of the 1954 Code the same language as had been contained in section 117(j) of the 1939 Code; and that such reenactment evidences Congressional approval of his regulations. However, we express no opinion as to the correctness of the *Maurer* case, since, unlike the instant case, it involved a casualty loss suffered in a year prior to the effective date of the amendment of section 1231 by the Technical Amendments Act of 1958. Even if section 1231 prior to its amendment covered only losses from the destruction of capital assets where there was an actual conversion into other property or money,[6] we think there can be no question, for the reasons stated above, that after its amendment it encompasses losses from the destruction of capital assets *not held for the production of income,* whether or not there was an actual conversion into other property or money. And it may be added that since the amendment specifically refers to casualty losses, and employs the terminology used in section 165(c)(3), there can be no question that Congress intended casualties to be included within the scope of compulsory or involuntary conversions referred to in section 1231.

The petitioners also cite *Oppenheimer* v. *United States,* (W.D. Mo.), 222 F. Supp. 194, in support of their contention. We consider such case inapposite since it also involved a casualty loss suffered in a year prior to the effective date of the amendment made to section 1231 by the Technical Amendments Act of 1958.

In addition, petitioners cite *Morrison* v. *United States,* (E.D. Tenn.) 230 F. Supp. 989, appeal pending C.A. 6. Such case involved a loss, not compensated for to any extent, resulting from the destruction by storm in 1960 of trees and shrubbery connected with a residence. The court, relying on *Maurer* v. *United States, supra,* held that sec-

[6] But see *Fred Draper,* 32 T.C. 545, in which we held that a loss sustained in 1949 from the destruction, by a windstorm, of a building used in the taxpayer's business, and not compensated for to any extent, was subject to the provisions of section 117(j) of the 1939 Code.

tion 1231 had no application and that the loss was allowable as an ordinary deduction under section 165 of the Code. The same court reached the same conclusions with respect to 1960 storm losses in *Killebrew* v. *United States*, 234 F. Supp. 481, and *Hall* v. *United States*, —— F. Supp. ——, appeals pending C.A. 6. For the reasons set forth hereinabove, we are unable to agree with the conclusions reached in the last three cited cases dealing with uncompensated casualty losses to residential property sustained in years governed by section 1231 as amended by the Technical Amendments Act of 1958.

In view of the foregoing, we approve the respondent's determination.

Decision will be entered for the respondent.

Reviewed by the Court.

SCOTT, J., concurs in the result.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 10,394

E. TAYLOR CHEWNING AND CAROLINE CHEWNING, HUSBAND AND WIFE, *Petitioners*,

versus

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

ON PETITION TO REVIEW THE DECISION OF THE TAX COURT OF THE UNITED STATES.

(Argued June 3, 1966. Decided June 22, 1966.)

Before HAYNSWORTH, Chief Judge BRYAN and J. SPENCER BELL, Circuit Judges.

David E. Wasserstrom (Goodwin, Rosenbaum, Meacham & White on brief) for Petitioners, and William A. Friedlander, Attorney, Department of Justice, (C. Moxley Featherston, Acting Assistant Attorney General, Lee A. Jackson and David O. Walter, Attorneys, Department of Justice, on brief) for Respondent.

PER CURIAM:

The petitioners seek review of the Tax Court's decision [1] that their uninsured loss from the destruction by storm of boxwood bushes located at their residence is not deductible as an ordinary loss under section 165(c)(3) of the Internal Revenue Code of 1954, but must be applied pursuant to section 1231 of the Code in reduction of the petitioners' gains from sales of property used in their trade or business.

We are persuaded by the able opinion of Judge Atkins that the Tax Court was correct in its interpretation of the Code and that we must reject the reasoning of *Maurer* v.

[1] The Tax Court's opinion is reported at 44 T.C. 678.

United States, 284 F. 2d 129 (10 Cir. 1960) in favor of that of *Morrison* v. *United States*, 355 F. 2d 218 (6 Cir. 1966). While the taxpayers' position was not without some basis in the language of section 1231 prior to the 1958 amendment (*Maurer* applied the statute as it existed before the amendment), we think that amendment [2] clearly indicated Congress' intention that the taxpayers' loss should not be excluded from treatment under section 1231. The judgment of the Tax Court is therefore

Affirmed.

(9144-7)

[2] See the Finance Committee Report to the Technical Amendments Act of 1958 (S. Rep. No. 1983, 85th Cong., 2d Sess. 74).

In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 478

E. TAYLOR CHEWNING and CAROLINE M. CHEWNING, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The issue in this case is whether § 1231 of the Internal Revenue Code of 1954 requires petitioners to offset a casualty loss against certain gains, as the Commissioner contends, or whether, as petitioners contend, they may deduct the casualty loss against their ordinary income.

Petitioners, in 1960, sustained an uninsured $8,500 loss to their personal residence resulting from snow storm damage to certain boxwood bushes located on

the premises. In the same year, they realized a $13,710 gain on the sale of breeding cattle which had been held by them for the production of income. On their 1960 tax return they treated the gain from the sale of cattle as capital gain under the provisions of § 1231(a) of the 1954 Code. They treated the casualty loss as an ordinary loss under the provisions of § 165(c)(3) of the 1954 Code. (Pet. 2-3.)

The Commissioner took the position that the casualty loss to petitioners' home, being a partial involuntary conversion of a capital asset held for more than six months and not held for the production of income, fell within § 1231, and that it thus had to be netted against the gain from the sale of the breeding cattle, with the excess of the gain over the casualty loss being treated as capital gain. The Tax Court sustained the Commissioner's determination in an opinion that was reviewed by the full court without dissent, and the Fourth Circiut affirmed. (Pet. 3.)

Section 1231 of the 1954 Code (Appendix, *infra*, pp. 5-6) provides, in general, that gains and losses from certain types of transactions shall be netted against each other, and that if the net result is a gain, it will be taxed as capital gain, but if the net result is a loss, it will be treated as an ordinary loss. The transactions covered by Section 1231 include (1) all gains and losses from "sales or exchanges of property used in the trade or business" and (2) all gains and losses from "the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure * * *) of property used in the

trade or business, and capital assets held for more than 6 months into other property or money."

Prior to 1958, § 1231 made no express reference to wholly uninsured casualty losses, and there is no indication that Congress had ever thought of them as a special class. In that year, however, Congress carefully considered whether uninsured casualty losses fell within § 1231. It amended the section to exclude from its coverage uninsured casualty losses to property (1) used in a business or (2) held for the production of income.[1] The Committee Report on the legislation stated (1) that before the amendment *all* uninsured losses were covered by § 1231, and (2) that after the amendment § 1231 would continue to cover uninsured casualty losses *on property held for personal use* but would thereafter not cover uninsured losses on property held for use in a business or for the production of income.[2] Therefore, regardless of what the law was before 1958, it is clear that after the 1958 amendment § 1231 covers uninsured casualty losses to property held for personal use for more than 6 months.

Petitioner argues that the instant decision conflicts with *Maurer* v. *United States*, 284 F. 2d 122

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[1] Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606, § 49(a). See App., *infra*, p. 6. This amendment was effective as to all tax years beginning after December 31, 1957. *Id.*, § 49(b); see also Treas. Reg. § 1.1231-1(e)(2), App., *infra*, p. 7.

[2] S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 74-75, 203-204 (1958-3 Cum. Bull. 922, 995-996, 1124-1125) (App., *infra*, pp. 7-9).

(C.A. 10). However, that case involved a pre-1958 casualty loss. Therefore, the language of the statute at the time of the transaction involved in *Maurer* was materially different from the statute here in question. There is no conflict among the courts of appeals as to the meaning of § 1231 as amended in 1958.

Moreover, the issue here is identical with that in *Morrison* v. *United States*, 355 F. 2d 218 (C.A. 6), in which the Court of Appeals for the Sixth Circuit reached precisely the same result as the Court of Appeals for the Fourth Circuit in this case. The taxpayer in the *Morrison* case filed a petition for a writ of certiorari, making substantially the same arguments as are set forth by the petitioners in the instant case. This Court, on June 13, 1966, denied the petition. 384 U.S. 986.

For the foregoing reasons, the petition for a writ of certiorari should be denied.

THURGOOD MARSHALL,
Solicitor General.

MITCHELL ROGOVIN,
Assistant Attorney General.

DAVID O. WALTER,
WILLIAM A. FRIEDLANDER,
Attorneys.

SEPTEMBER, 1966.

APPENDIX

Internal Revenue Code of 1954:

SEC. 1231. [as amended by Sec. 49(a), Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606]. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.[1]

(a) *General Rule.*—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the

[1] Material added by the Technical Amendments Act of 1958 (*infra*, p. 6) shown in italics.

extent taken into account in computing taxable income, except that section 1211 shall not apply; and

(2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

In the case of any property used in the trade or business and of any capital asset held for more than 6 months and held for the production of income, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft.[2]

* * * * *

(26 U.S.C. 1231.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.1231-1. *Gains and losses from the sale or exchange of certain property used in the trade or business.*

* * * * *

(e) *Involuntary conversion.* — (1) *General rule.* * * * Losses upon the complete or partial destruction, theft, seizure, requisition or condemnation of property are treated as losses upon an involuntary conversion whether or not there is a conversion of the property into other prop-

[2] See note 1.

erty or money unless subparagraph (2) of this paragraph applies. For example, if a capital asset held for more than 6 months, with an adjusted basis of $400, but not held for the production of income, is stolen, and the loss is not compensated for by insurance or otherwise, section 1231 applies to the $400 loss.

(2) *Certain uninsured losses.* Notwithstanding the provisions of subparagraph (1) of this paragraph, losses sustained during a taxable year beginning after December 31, 1957, with respect to both property used in the trade or business and any capital asset held for more than 6 months and held for the production of income, which losses arise from fire, storm, shipwreck, or other casualty, or from theft, and which are not compensated for by insurance in any amount, are not losses to which section 1231(a) applies. Such losses shall not be taken into account in applying the provisions of this section.

* * * * *

(26 C.F.R., Sec. 1.1231-1.)

S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 74-75, 203-204 (1958-3 Cum. Bull. 922, 995-996, 1124-1125):

Under present law where there are uninsured losses on property as a result of its destruction, theft, seizure, requisition, or condemnation, such losses, in the case of property used in the trade or business or capital assets held for more than 6 months, are treated as section 1231 losses.

* * *

Where a taxpayer elects to be a self-insurer against casualty losses, there seldom is a con-

version into money or other property, as there would be if the destroyed property were insured. If this casualty loss were the only loss incurred during the taxable year by the self-insured person, he would be entitled to the full benefit of an ordinary loss deduction under section 1231, but where there are also 1231 gains, the casualty loss is partially or wholly offset against these gains which would otherwise be taxed as capital gains. * * *

* * * The provision added makes section 1231 inapplicable in the case of losses where the taxpayer is not compensated for the loss by insurance, if the loss arises from fire, storm, shipwreck, or other casualty or from theft. This treatment is to apply, however, only in the case of property used in the trade or business and in the case of capital assets held for more than 6 months and held for the production of income. * * *.

* * * * *

This section amends section 1231(a) of the 1954 Code by making it inapplicable to any loss in respect of which the taxpayer is not compensated by insurance in any amount if the loss arose from fire, storm, shipwreck, or other casualty, or from theft, and the loss occurred with respect to property used in the trade or business or a capital asset held for more than 6 months and held for the production of income.

Under Section 1231, uninsured casualty losses on depreciable property or real estate used in the trade or business or on capital assets must be aggregated with various other types of section 1231 gains and losses. * * *

Your committee has provided this section to separate certain uninsured casualty losses from the computation of section 1231 gain or loss, but only with respect to property used in the trade or business and capital assets held for the production of income which have been held more than 6 months. The amendment applies with respect to, for example, loss incurred as a result of the destruction of a taxpayer's oil tanks which he used for oil storage in his trade or business, but on which he was unable to obtain insurance. On the other hand, the amendment does not apply to loss arising from the destruction or theft of the taxpayer's uninsured personal automobile.

* * *

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